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How CPAs solve the problems of small business owners: A Talk for practitioners

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HOW CPAS SOLVE THE PROBLEMS
OF SMALL BUSINESS OWNERS

A TALK FOR PRACTITIONERS

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BEFORE THIS BUSINESS DAY IS OVER, MORE THAN 180 COMPANIES IN OUR NATION WILL DECLARE BANKRUPTCY. I'M NOT SAYING THAT FOR ITS SHOCK VALUE, BUT ONLY TO SET THE STAGE FOR OUR DISCUSSION ON WHAT PREVENTIVE STEPS BUSINESS OWNERS SHOULD BE TAKING IN OUR COMPETITIVE ECONOMY.

TODAY I WANT TO APPLY A CASE STUDY APPROACH TO THE PROBLEM OF COPING WITH A FLUCTUATING ECONOMY. I HOPE TO CONVINCE YOU THAT THE PROBLEMS YOU ENCOUNTER CAN BE SOLVED WITH SOUND MANAGEMENT AND COMPREHENSIVE FINANCIAL PLANNING.

I'M GOING TO SIDESTEP TAX PROBLEMS BECAUSE THEY REMAIN THE SAME NO MATTER WHAT THE STATE OF THE ECONOMY. HOWEVER, IF YOU HAVE SPECIFIC QUESTIONS ON TAXES I'LL TRY TO HELP IN A QUESTION AND ANSWER PERIOD LATER.

THE PROBLEMS WE DISCUSS WILL BE PROBLEMS ENCOUNTERED BY SMALL BUSINESS OWNERS LIKE YOURSELVES. PROBLEMS THAT SEEM TO ARISE FROM NO READILY DISCERNIBLE SOURCE; PROBLEMS THAT GROW UNNOTICED UNTIL THEY BECOME A THREAT TO YOUR BUSINESS. TOO OFTEN THEY COULD HAVE BEEN AVOIDED IF PREVENTIVE STEPS HAD BEEN TAKEN.

LET'S LOOK THEN AT THE MOST COMMON PROBLEMS THAT I HAVE BEEN ASKED TO HELP SOLVE. USUALLY, THEY FALL INTO TWO CATEGORIES: THE OBVIOUS AND THOSE MORE SUBTLE STRUCTURAL PROBLEMS THAT ARE EMBEDDED IN THE BUSINESS ORGANIZATION.

THE MOST OBVIOUS PROBLEMS ARE POOR CASH FLOW AND NET OPERATING LOSSES. UNFORTUNATELY, THESE PROBLEMS ARE TOO OFTEN SO SERIOUS THAT LITTLE CAN BE DONE ABOUT THEM. BUT THERE ARE A NUMBER OF THINGS THAT CPAS CAN DO TO CUT BACK ON NET OPERATING LOSSES AND CASH OUTLAYS AND, AT THE SAME TIME, MAKE AVAILABLE CASH THAT HAS BEEN TIED UP UNNECESSARILY.

HERE'S WHAT YOU CAN DO. ATTACK ON TWO LEVELS: LONG-TERM AND SHORT-TERM. THE LONG-TERM ATTACK INVOLVES DEVELOPING A TAX STRATEGY TO REDUCE THE AMOUNT OF CASH YOU USE TO PAY TAXES AND TO INCREASE THE AMOUNT YOU SAVE, SHELTER OR GET REFUNDED. THIS IS CALLED MAXIMIZING TAX RECOVERY AND MINIMIZING TAX OUTLAY. RATHER THAN GET INTO THE TECHNICALITIES OF THIS PROCESS, LET ME JUST SAY THAT IT IS PART OF THE OVERALL FINANCIAL PLANNING ADVICE THAT CPAS ARE CALLED ON TO GIVE EVERY DAY.

SHORT-TERM WAYS OF INCREASING CASH FLOW ARE WORTH EXAMINING IN DETAIL BECAUSE YOU CAN PUT THEM TO WORK IMMEDIATELY. THEY INCLUDE SUCH FUNDAMENTAL IDEAS AS:

- DON'T REPAY BILLS AND DON'T PAY THOSE YOU OWE UNTIL JUST BEFORE THEY ARE DUE;
- ASK YOUR CUSTOMERS FOR CASH PAYMENTS RATHER THAN GRANTING THEM CREDIT. ENFORCE YOUR CREDIT POLICIES;

- WRITE SALES CONTRACTS THAT ENTITLE YOU TO INTEREST AND COLLECTION FEES IF YOU'RE NOT PAID ON TIME;
- SEND OUT BILLS WEEKLY IF THAT'S NECESSARY;
- OFFER ONE-TIME DISCOUNTS TO CLOSE LONG-STANDING ACCOUNTS RECEIVABLE;
- CONCENTRATE MOST OF YOUR COLLECTION EFFORTS ON LARGER OUTSTANDING DEBTS; DON'T WASTE TIME TRYING TO COLLECT THE SMALL ONES.

USING THIS APPROACH NECESSITATES ACCURATE ACCOUNTING SYSTEMS. IN FACT, IT'S LIKELY THAT IF GOOD ACCOUNTING AND BOOKKEEPING SYSTEMS WERE IN PLACE AT THE OUTSET, YOU MIGHT NEVER HAVE GOTTEN INTO A CASH FLOW CRUNCH.

THAT PROBLEM IS AS BASIC AS YOU CAN GET. BUT HERE IS ANOTHER ONE ALONG THAT SAME LINE:

A RESTAURANT OWNER CAME TO ME WITH A PROBLEM ALL TOO COMMON TO THAT INDUSTRY. HE FOUND THAT HE DID NOT HAVE THE RIGHT ITEMS IN SUPPLY AT THE END OF THE WEEK; HE ALSO STRONGLY SUSPECTED THAT HIS WAITERS AND CASHIERS WERE "FLOATING CHECKS," OR SUBSTITUTING CHECKS WITH LOWER TOTALS FOR WHAT WAS REALLY EATEN AND POCKETING THE DIFFERENCE. ONE SOLUTION SOLVED BOTH PROBLEMS.

THE OWNER INSTALLED A COMPUTERIZED CASH REGISTER SYSTEM. EACH ITEM THAT IS ORDERED AND ITS PRICE ARE ENTERED ON THE CHECK BY THE MACHINE BEFORE THE ORDER GOES TO THE KITCHEN. THIS MAKES IT VIRTUALLY IMPOSSIBLE TO ALTER THE CHECK OR SUBSTITUTE ANOTHER CHECK FOR A LESSER TOTAL -- PROBLEM

NUMBER ONE SOLVED. AT THE SAME TIME, IT PROVIDES A RUNNING INVENTORY OF ITEMS ORDERED. IT CAN ALSO BE PROGRAMMED TO TELL YOU WHAT ITEMS YOU HAVE IN STOCK AND WHAT YOU NEED TO ORDER -- PROBLEM NUMBER TWO SOLVED.

NOW, I MENTIONED THIS BECAUSE IT ILLUSTRATES HOW IMPORTANT COMPUTERS ARE. FOR THIS REASON, MANY CPAS HAVE EXTENSIVE COMPUTER EXPERIENCE AND CAN ADVISE WHETHER A BUSINESS NEEDS AN ELECTRONIC DATA PROCESSING SYSTEM AND, IF SO, WHICH SYSTEM IS BEST FOR THEM. INDEED, MANY CPAS ARE INSTALLING COMPUTERS IN THEIR OWN OFFICES. WE TAKE OUR OWN ADVICE.

ANOTHER OF THE MORE COMMON NON-TAX PROBLEMS INVOLVES ACTING AS THE CONTROLLER FOR A SMALL COMPANY. MANY OF OUR CLIENTS MANAGE AND OWN BUSINESSES THAT ARE NOT LARGE ENOUGH TO AFFORD A FULL-TIME CONTROLLER OR FINANCIAL OFFICER. INSTEAD, THEY ENGAGE CPAS TO PROVIDE THESE FUNCTIONS ON A PERIODIC, BUT ONGOING, BASIS.

ANOTHER RELATED CONCERN IS HELPING BUSINESSES APPLY FOR CREDIT. EVEN IF AT TIMES IT SEEMS IMPOSSIBLE TO OBTAIN A LOAN, BANKS ARE STILL IN THE MONEY-LENDING BUSINESS. IT'S JUST THAT THEY ARE MORE PRUDENT ABOUT LENDING FUNDS TODAY.

WHEN A COMPANY SEEKS CREDIT, THE CPA'S ROLE IS TO HELP THE CLIENT PRESENT THE COMPANY'S FINANCIAL POSITION IN THE BEST POSSIBLE LIGHT. THE BANK WANTS TO BE SURE THAT THE LOAN WILL BE USED FOR A PURPOSE THAT WILL MAKE THE BUSINESS GROW RATHER

THAN SOLVE A SHORT-TERM CASH DEFICIT. CPAS ALSO PREPARE FINANCIAL PROJECTIONS THAT SHOW HOW THE COMPANY CAN PAY BACK THE LOANS.

AND IN DOING THOSE PROJECTIONS, SOME NOT-SO-VISIBLE PROBLEMS MAY COME TO LIGHT. IN FACT, SOMETIMES THE ONLY WAY TO DISCOVER THE PROBLEMS EARLY, IS THROUGH INTENSIVE FINANCIAL DETECTIVE WORK. HERE'S AN EXAMPLE:

THE OWNER OF WHAT SEEMED A THRIVING MANUFACTURING COMPANY CAME TO ME WITH A ROUTINE REQUEST. HE ASKED US TO PREPARE HIS FINANCIAL STATEMENTS. THE QUESTION IN THE BACK OF HIS MIND WAS, DO I NEED TO RECAPITALIZE?

IN THE COURSE OF PREPARING THESE STATEMENTS, WE HAD TO EXAMINE THE COMPANY'S FINANCIAL STRUCTURE AND ITS OPERATION. WE TURNED UP DATA IN THE FORM OF PRODUCTION RATIOS THAT WERE WAY OUT OF LINE IN COMPARISON WITH SIMILAR BUSINESSES.

HIS COMPANY HAD A HISTORY OF PROFIT AND GROWTH, A STABLE MANAGEMENT AND MODEST EXPANSION. IT GAVE THE APPEARANCE OF BEING WELL ORGANIZED AND EFFICIENT. IT WAS A JOLT, THEN, TO DISCOVER ITS PROFITS WERE DOWN SIGNIFICANTLY, ESPECIALLY SINCE THAT FACT HAD NOT YET SHOWN UP IN THE PROFIT AND LOSS STATEMENTS. TO COMPOUND MY SURPRISE, THE OWNER DIDN'T REALIZE HE HAD A PROBLEM.

WE SAT DOWN AND TALKED WITH THE OWNER. IT TURNED OUT HE WAS DEEPLY DISTRESSED WITH HIS OVERALL BUSINESS SITUATION. FURTHER DISCUSSION REVEALED THAT HE FELT INADEQUATE TO THE CHALLENGE OF DEALING WITH THE SPIRALLING ADMINISTRATIVE AND TECHNICAL DETAILS OF A GROWING BUSINESS. CLEARLY, THE BUSINESS HAD OUTGROWN THE ABILITIES OF ITS OWNER.

THE SITUATION HAD A HAPPY ENDING FOR HIM. WE RECOMMENDED HIRING A HIGH LEVEL MANAGER OR SELLING THE BUSINESS. WITH A GREAT SENSE OF RELIEF, THE OWNER SOLD THE BUSINESS AT A HANDSOME PROFIT. THEN HE WENT BACK TO WHAT HE REALLY WANTED -- A SMALLER, LESS COMPLICATED OPERATION.

BUT, UNFORTUNATELY, NOT ALL PROBLEMS HAVE HAPPY ENDINGS. EVEN THOUGH I PROMISED TO AVOID TAXES, ONE SITUATION OCCURS TO ME THAT DEMONSTRATES WHAT CAN HAPPEN IF PROPER PLANNING IS NOT CARRIED OUT. HOW OFTEN HAVE YOU HEARD OF A SUCCESSFUL BUSINESS BEING SOLD? NOT BECAUSE THE OWNERS WANTED TO, BUT BECAUSE THEY HAD TO? IT'S NOT UNUSUAL, IS IT? MOST OFTEN THE SITUATION ARISES WHEN THE PRINCIPAL OWNER DIES WITHOUT MAKING SATISFACTORY ESTATE PLANNING ARRANGEMENTS. ALTHOUGH THE OWNER HAD EXPECTED HIS HEIRS TO CARRY ON THE BUSINESS, THEY ARE FORCED TO SELL IT TO PAY THE ESTATE TAXES.

THAT IS A TRAGEDY -- ALL THE MORE SO BECAUSE IT COULD BE AVOIDED BY PROPER ESTATE PLANNING. AND IT IS AN AREA OF OVERALL FINANCIAL PLANNING THAT CPAS ARE FREQUENTLY CALLED UPON TO HELP WITH.

WHILE FINANCIAL PLANNING IS CRITICAL, IT'S NOT THE ONLY TYPE OF PLANNING CAN CONTRIBUTE TO A BUSINESS' SUCCESS. THERE ARE OTHER FACTORS TO CONSIDER.

A CASE THAT COMES TO MIND INVOLVED A BUSINESS WHICH WAS NOT DOING WELL AND AT FIRST GLANCE, IT WAS DIFFICULT TO TELL WHY. ONCE IDENTIFIED, HOWEVER, THE SOLUTION WAS OBVIOUS.

THIS BUSINESS WAS A JEWELRY STORE, CARRYING SOME EXPENSIVE ITEMS. THE BUSINESS WAS ADEQUATELY CAPITALIZED, NOT OVEREXTENDED, NOT OVERSTOCKED WITH INVENTORY THAT HAS YET TO BE PAID. THE OWNER COMPLIED WITH SOUND MANAGEMENT PRACTICES. THE TOWN HAD SUFFICIENT POPULATION AND INCOME TO SUPPORT IT.

BUT PEOPLE WEREN'T BUYING. IT TOOK US A WHILE TO FIGURE OUT THE PROBLEM: WE DISCOVERED THAT THE STORE WAS LOCATED IN THE WRONG PLACE. IT WAS IN A MEDIUM-SIZED SHOPPING CENTER ON A MAIN ARTERY HEAVILY TRAVELED IN RUSH HOURS. CROWDS STOPPED HERE, OFTEN ON THE WAY HOME FROM WORK.

THE CATCH WAS THAT THE OTHER STORES IN THE CENTER SOLD CONVENIENCE ITEMS OR SERVICES: THEY WERE GROCERY STORES, LIQUOR STORES, FAST FOOD PLACES, CLEANING ESTABLISHMENTS. SHOPPERS DIDN'T STOP IN THE SHOPPING CENTER TO DO THE KIND OF SHOPPING THAT NEEDS TIME AND CONSIDERATION, LIKE BUYING JEWELRY.

WHAT SEEMED LIKE A LOGICAL LOCATION, CONSIDERING TRAFFIC PATTERNS AND CUSTOMER INCOMES, TURNED OUT TO BE TOTALLY WRONG BECAUSE OF THE NATURE OF THE STORES SHARING THE SHOPPING CENTER. I'M HAPPY TO REPORT THAT THE JEWELRY STORE HAS RELOCATED IN AN AREA OF SPECIALTY STORES AND IS FLOURISHING.

IF YOU WILL RECALL THE STORY OF THE OWNER WHO SOLD HIS BUSINESS BECAUSE IT OUTGREW HIM, YOU WILL RECOGNIZE THAT MANY TIMES THE PROBLEMS WE END UP WORKING ON ARE NOT THOSE THE OWNER BROUGHT TO US. OFTEN WE DISCOVER THEM IN THE COURSE OF WORKING ON AN OTHERWISE ROUTINE ENGAGEMENT.

TOO MANY TIMES, THESE HIDDEN PROBLEMS TURN OUT TO BE THE MOST SERIOUS. IF THEY ARE NOT CAUGHT IN TIME, THEY CAN CAUSE THE COMPANY TO FAIL.

FORTUNATELY, THE NATURE OF THE ENGAGEMENTS WE PERFORM WHEN ACTING AS CONTROLLER -- ACCOUNTING, AUDITING AND TAX PLANNING -- PUT US IN THE POSITION TO UNCOVER HIDDEN PROBLEMS AND HEAD THEM OFF.

STUDIES HAVE DETERMINED THAT THE MOST PREVALENT CAUSE OF BUSINESS FAILURE IS NOT LACK OF CAPITAL OR INADEQUATE FINANCING; IT IS MANAGEMENT ERROR. AND MANAGEMENT ERROR IS NOT, IN MY OPINION, THE RESULT OF INCOMPETENCE OF MANAGEMENT, BUT INSUFFICIENT KNOWLEDGE.

IT WOULD SEEM TO ME THAT IF BUSINESS OWNERS REALIZED WHAT THEY LACK IN KNOWLEDGE, PARTICULARLY IN SOME SPECIALIZED AREA, THEY WOULD SEEK HELP FROM COMPETENT ADVISORS.

NOW I DON'T PRESUME TO SUGGEST THAT CPAS CAN SAVE EVERY COMPANY FROM FAILURE. COMPETITION, LACK OF CAPITAL, POOR MANAGEMENT AND THE ECONOMY WILL TAKE ITS TOLL.

BUT IF I HAVE DONE NOTHING ELSE TODAY, I WOULD HOPE THAT I HAVE AT LEAST SHOWN YOU THAT PROBLEMS YOU ARE LIKELY TO ENCOUNTER DO NOT SOLVE THEMSELVES. AND SOME THAT START OUT AS RELATIVELY MINOR PROBLEMS CAN LEAD TO SERIOUS CONSEQUENCES IF THEY AREN'T STOPPED AND CORRECTED EARLY.

ESPECIALLY IN TODAY'S ENVIRONMENT, BUSINESS OWNERS NEED ALL THE HELP THEY CAN GET. THERE ARE THOUSANDS OF CPAS IN THIS COUNTRY IN PUBLIC PRACTICE. MANY OF THESE CPAS ARE ASSOCIATED WITH SMALL, LOCAL FIRMS, IN EVERY CITY AND MOST TOWNS. THEY HAVE THE EXPERTISE AND THE DESIRE TO HELP YOU WHERE IT CAN DO YOU THE MOST GOOD -- ON THE BOTTOM LINE.

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